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SENATE BILL 7063 By
Dixon

HOUSE BILL 85 of the First Extraordinary Session
By McDaniel

AN ACT to amend Tennessee Code Annotated, Title 67, to enact the "Tennessee Tax Reform Act of 1999". This act makes appropriations in fiscal year 1999-2000 for the purpose of defraying the expenses incurred from the implementation of this act.

WHEREAS, there exists a need to reform the tax laws of the state to provide an equitable and less regressive means of taxation that will produce adequate and reliable sources of revenues; and

WHEREAS, the Attorney General has opined that Article 2, Section 28 of the Constitution of Tennessee does not prohibit the General Assembly from enacting an ad valorem property or privilege tax based upon the income of an individual; and

WHEREAS, the Attorney General has further opined that it is within the inherent power of the General Assembly to impose such tax; and

WHEREAS, it is not the intention of the General Assembly to designate the nature of the tax levied by this act but it is intended that the tax imposed be construed to be a privilege tax, property tax or such other tax on income that is within the inherent authority of the General Assembly to enact; now, therefore,

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF TENNESSEE:

SECTION 1. As used in this act, unless the context otherwise requires:

(1) "Another state" means another state, the District of Columbia, or a territory or possession of the United States.

(2) "Commissioner" means the commissioner of revenue.

(3) "Department" means the department of revenue.

(4) "Employee" means and includes every individual who is a resident of or domiciled in the state of Tennessee performing services for an employer, either within or without or both within and without the state of Tennessee, or any individual performing services within the state of Tennessee, the performance of which services constitutes, establishes, and determines the relationship between the parties as that of employer and employee, and includes officers of corporations and individuals, including elected officials, performing services for the United States government or any agency or instrumentality thereof or the state of Tennessee or any county, city or municipality, or political subdivision thereof.

(5) "Employer" means a natural person, subchapter S corporation, partnership, limited liability company, limited partnership, proprietorship, cooperative, state-chartered or national bank, state or federally chartered savings and loan association, regulated investment company, association, joint-stock company, business trust, corporation, or other form of organization, whether domestic or foreign, transacting business in or deriving income from sources within the state of Tennessee for whom an individual performs or performed any services, of whatever nature, who has control of the payment of wages for such services or is the officer, agent, or employee of the person having control of the payment of wages; or the state of Tennessee, or any department, political subdivision, county, or municipality thereof or any other governmental entity, which has in its employ one (1) or more individuals performing services for it.

(6) "Resident individual" means a natural person who is domiciled in this state and a natural person who maintains a permanent place of abode within this state and

who spends in the aggregate more than six (6) months of the taxable year within this state. A "nonresident individual" means an individual other than a resident individual.

(7) "Wages" means any remuneration for services performed by an employee for an employer, including the cash value of all such remuneration paid in any medium or form other than cash.

(8) Any term used in this act shall have the same meaning as when used in a comparable context in the federal "Internal Revenue Code of 1986," as amended. Any reference in this part to the "Internal Revenue Code" means the provisions of the "Internal Revenue Code of 1986," and amendments thereto, and other provisions of the laws of the United States relating to federal income taxes, as the same may be or become effective at any time or from time to time, for the taxable year.

SECTION 2. An income tax in the amount of two and one-half percent (2 1/2%) per annum is levied on the federal adjusted gross income of every individual subject to the following adjustments:

(1) There shall be subtracted from the federal adjusted gross income any interest income on obligations of the United States and its possessions to the extent included in federal adjusted gross income; and

(2) A deduction based upon the number of personal exemptions is provided in the amount of four thousand dollars (\$4,000) for each personal exemption.

Taxpayers filing jointly shall be allowed two (2) personal exemptions. Taxpayers, whether filing singly or jointly, shall be allowed additional personal exemptions for each dependent claimed. Dependents filing a separate return as required by federal law shall not be entitled to an exemption.

SECTION 3. The tax herein provided for is for state purposes only, and no county or municipality shall have power to levy the same.

SECTION 4. Revenues generated by the income tax provided for by this act are earmarked for the general fund.

SECTION 5. If the federal adjusted gross income of a husband or wife, or both, is determined on separate federal returns, such income for purposes of the Tennessee income tax shall be separately determined. If the federal adjusted gross income of a husband and wife is determined on a joint federal return, their tax shall be determined on their joint federal adjusted gross income.

SECTION 6. (a) On each income tax return, a credit shall be allowed to a resident individual who has income derived from sources in another state as follows:

(1) For purposes of ascertaining the Tennessee income tax due by a resident individual whose adjusted gross income includes income derived from sources in another state, the Tennessee income tax shall first be computed as if all of the income of the resident were derived from sources within Tennessee. A credit shall then be given on the tax so computed for the amount of income tax actually accrued to another state because of income from sources within that state. This credit shall be subject to the following limitations:

(A) The credit shall not exceed the tax which would be due on the income, if added to the income subject to Tennessee tax, and calculated at the Tennessee income tax rate.

(B) The credit shall not include interest and penalties paid to another state.

(2) If accrued taxes when paid differed from the amounts claimed as credits by the taxpayer, or if any tax paid is refunded in whole or in part, the taxpayer shall notify the commissioner who shall determine the amount of tax due for the years affected. In the case of such a tax accrued but not paid, the commissioner, as a condition precedent to the allowance of a credit, may require the taxpayer to deposit a surety bond or other

security acceptable to the commissioner in such amount as the commissioner may require, conditioned upon the payment by the taxpayer of any amount of tax found to be due upon any such determination.

(b) The credits provided for in this section, irrespective of the method of accounting employed by the taxpayer in keeping such taxpayer's books, shall be taken in the year in which the taxes of another state accrue, subject to the conditions prescribed in this section.

(c) The credits provided by this section shall be allowed only if the taxpayer furnishes to the commissioner all information necessary for the verification and computation of such credits as the commissioner may require.

SECTION 7. (a) In the case of a nonresident individual, the tax imposed shall be on the Tennessee nonresident federal adjusted gross income.

(b) "Tennessee nonresident federal adjusted gross income" means that part of the individual's federal adjusted gross income as determined pursuant to Section 62 of the Internal Revenue Code derived from sources within Tennessee when such income is attributable to:

(1) The ownership of any interest in real or tangible personal property in Tennessee;

(2) A business, trade, profession, or occupation carried on in Tennessee;

(3) The taxpayer's distributive share of partnership or limited liability company income, gain, loss, and deduction to the extent such income is derived from sources within Tennessee;

(4) The taxpayer's share of estate or trust income, gain, loss, and deduction to the extent such income is derived from sources in Tennessee; or

(5) Income from intangible personal property, including annuities, dividends, interest, and gains from the disposition of intangible personal property to the extent that

such income is from property employed in a business, trade, profession, or occupation carried on in Tennessee.

(c) If the federal adjusted gross income of a husband or wife, or both, both of whom are nonresidents, is determined on separate federal returns, their Tennessee adjusted gross incomes shall be separately determined. If the federal adjusted gross income of a husband and wife, both of whom are nonresidents, is determined on a joint federal return, their tax shall be determined on their joint Tennessee nonresident federal adjusted gross income.

SECTION 8. (a) In the case of an individual who is a resident of Tennessee for part of the individual's taxable year, the tax shall be apportioned in the ratio of that part of such individual's federal adjusted gross income which relates to the period of the year such individual was a Tennessee resident to the individual's total federal adjusted gross income.

(b) A taxpayer filing a part-year resident return shall also file as a nonresident for the remaining portion of such resident's federal taxable year in the event the taxpayer has income within such remaining portion derived from sources within Tennessee.

SECTION 9. (a) The taxpayer's taxable year under this act shall be the same as such taxpayer's taxable year for federal income tax purposes. If a taxpayer's taxable year is changed for federal income tax purposes, the taxable year for purposes of this act shall be similarly changed.

(b) The taxpayer's method of accounting under this act shall be the same as is the method of accounting for federal income tax purposes. If a taxpayer's method of accounting is changed for federal income tax purposes this act shall be similarly changed.

SECTION 10. (a) Every employer making payment of wages shall deduct and withhold from each wage payment of an employee two and one-half percent (2 1/2%) of the wages paid, subject to the exemptions provided below, in order to approximate the income tax due to the state of Tennessee by the employee subject to rules promulgated by the commissioner. The

employer shall withhold the state income tax in the same manner and at the same time as amounts are withheld from the employee's wages for federal tax purposes.

(b) An employee receiving wages is entitled to an exemption from withholding for state income tax purposes equal to the amount of deductions based on personal exemptions to which the employee is entitled for the tax year under this act.

(c) The employee shall furnish the employer a signed exemption certificate showing the number of withholding exemptions claimed for state income tax purposes at the same time an exemption certificate is required to be filed with an employer by the Internal Revenue Service or at such time as otherwise required by the commissioner.

(d) An employer shall not be required to deduct and withhold any tax under this act upon a payment of wages to an employee if there is in effect with respect to such payment a withholding exemption certificate furnished to the employer by the employee certifying that the employee anticipates he will incur no liability for income tax imposed under this act as a result of application of the deductions to which such employee is entitled for the employee's current taxable year.

(e) Every employer, irrespective of whether or not such employer deducted and withheld the amounts as provided in this section, shall be liable for the amounts required to be deducted and withheld unless, in the case of any failure to deduct and withhold such amounts, it is shown that such failure was due to reasonable cause and not due to willful neglect. If the employer in violation of the provisions of this section, fails to deduct and withhold the amounts as provided in this section and thereafter the tax against which such deducted and withheld amounts would have been credited is paid, the amounts so required by this section to be deducted and withheld shall not be collected from the employer; but in no such case, unless due to reasonable cause, shall the employer be relieved from liability for any penalties or additions to the amounts required under this section to be deducted and withheld otherwise applicable to any such failure to deduct and withhold.

(f) Every employer subject to the provisions of this section shall file a return, in such form as shall be determined by the department of revenue, and remit the amount withheld in accordance with the time schedule established for the remittance of withholding tax by the Internal Revenue Code, as amended, and any regulations thereto. Failure to remit the amount withheld timely shall subject the employer to those penalties and interest applicable under Tennessee Code Annotated, Sections 67-1-801 and 67-1-804.

(g) Every employer subject to the provisions of this section who operates a business on a seasonal basis shall file a return and remit the tax withheld on or before the fifteenth day of the following month for each month during which the business is operated. The employer shall state the months during which the employer expects to operate the business and shall notify the department of revenue of any changes in the months of operation.

(h) All amounts deducted and withheld shall be considered as tax collected under the provisions of this section and no employee shall have any right of action against an employer in respect to any monies so deducted and withheld from wages and paid over to the department in compliance or intended compliance with this section.

(i) Every employer shall, in accordance with such regulation as shall be prescribed by the department of revenue, provide each employee with a statement of the amount of money deducted and withheld from such employee's wages in accordance with the provisions of this section. Every employer shall also make an annual statement for each employee to the department of revenue, on such forms as are provided or approved by the department, a copy of which shall be provided each employee, summarizing the total compensation paid and the tax withheld for such employee during the preceding calendar year or any portion thereof, and the said annual statement shall be filed on or before March 15 of the year following that for which the report is made. Failure to file the statements within the time prescribed therefor, unless shown to have been due to reasonable cause, or the willful filing or furnishing of false or fraudulent statements, shall subject the employer to a penalty, at the discretion of the

commissioner, of not less than fifty dollars (\$50.00) nor more than two hundred fifty dollars (\$250.00), which shall be in addition to any criminal penalty otherwise provided for failure to file a return or for filing a false or fraudulent return.

(j) Every employer who deducts and withholds any amounts under the provisions of this section shall hold the same in trust for the state of Tennessee for the payment thereof to the department in the manner and at the time provided in this section, and the state of Tennessee and the department shall have a lien to secure the payment of any amounts withheld and not remitted as provided in this section upon all of the assets of the employer and all property, including stock in trade, business fixtures, and equipment, owned or used by the employer in conducting business, so long as any delinquency continues. The lien of the state shall be entitled to the same priority established for other tax liens by Tennessee Code Annotated, Section 67-1-1403, and the taxes owed may be collected in the same manner as other state taxes.

(k) The commissioner may establish by rule periodic filing and payment dates in those instances where the commissioner deems it to be in the best interests of the state to do so.

(l) Every employer required to withhold wages under this section shall register with the department on or after July 1, 1999, in such manner as the department may require. Any employer who fails to register for withholding by October 1, 1999, shall be subject to a penalty to be determined by the commissioner, not to exceed one thousand dollars (\$1,000). Any employer who becomes subject to this act after September 1, 1999, shall register within thirty (30) days of the date of becoming an employer within the meaning of this act, and shall be subject to the aforementioned penalty for failure to timely register.

(m) Liability for taxes or withholding under this act may be challenged only upon compliance with the provisions of Tennessee Code Annotated, Section 67-1-1801, or Section 67-1-1802; except that, prior to January 1, 2000, any employer required to register for withholding or any person subject to the tax may challenge the constitutionality or validity of

such requirement by instituting an action for declaratory relief. Such action must be brought in the Chancery Court of Davidson County. Such action shall be granted priority and be expedited by the court.

SECTION 12. (a) Whenever a resident individual or a nonresident individual with income from Tennessee sources is required to file a federal income tax return under the provisions of Section 6012 of the Internal Revenue Code, the individual shall also be required to file a Tennessee income tax return with the commissioner of revenue on or before the fifteenth day of the fourth month following the close of the individual's taxable year.

(b) The appropriate tax must be paid to the department of revenue at the time of filing the return by the individual.

(c) Additional payments shall be made as follows:

(1) Every individual who can reasonably be expected to have gross income from sources other than wages in excess of twenty-five thousand dollars (\$25,000) for such individual's taxable year shall file on or before the fifteenth day of the fourth month of such taxable year a declaration of estimated income tax in Tennessee on income other than wages subject to withholding.

(A) The declaration of estimated tax shall be the lesser of:

(i) Ninety percent (90%) of the tax shown on the return for the taxable year (or, if no return is filed, ninety percent (90%) of the declaration of estimated tax), or

(ii) One hundred percent (100%) of the tax shown on the individual's tax return for the preceding tax year.

(B) Subitem (ii) of subdivision (1)(A) shall not apply if the individual was not a resident of Tennessee for the preceding twelve (12) months or if the individual did not file a tax return for the preceding year.

(C) Based upon this declaration, the individual shall make four (4) equal quarterly tax payments for such individual's taxable year.

(D) The first payment shall be due on the fifteenth day of the fourth month of an individual's taxable year; the second payment on the fifteenth day of the sixth month; the third payment on the fifteenth day of the ninth month; and the final payment on the fifteenth day of the first month of the subsequent taxable year.

(E) With the annual return filed with the commissioner, the individual shall either make payment of additional tax due according to that return or shall file for a refund based on an overpayment of tax and shall be paid accordingly by the department.

(2) If there is an underpayment of estimated tax, then there shall be added to the tax for the taxable year an amount determined by multiplying the amount of the underpayment by the rate of interest determined in accordance with Tennessee Code Annotated, Section 67-1-801(a)(1)(A) for the period of the underpayment.

(A) The amount of the underpayment shall be the excess of the required installment over the amount, if any, of the installment paid on or before the due date for the installment.

(B) The period of underpayment shall extend from the date the installment was required to be paid to the earlier of:

(i) The fifteenth day of the fourth month following the close of the taxable year; or

(ii) With respect to all or any portion of the underpayment, the date on which all or any portion of the underpayment is paid.

(C) A payment of estimated tax on any installment date shall be considered a payment of any previous underpayment only to the extent such payment exceeds the amount of the installment payable for that date.

(3) Amended or revised declarations may be made in any case in which an individual estimates that such individual's gross income, deductions, or credits will materially change the estimated tax reported in the previous declaration. If any amendment of a declaration is filed, the remaining installments, if any, shall be ratably increased or decreased, as the case may be, to reflect such increase or decrease in the estimated tax by reason of such amendment.

(4) If the federal adjusted gross income of a husband and wife is determined on a joint federal return, a husband and wife may make a joint declaration of estimated tax as if they were one taxpayer, in which case the liability with respect to the estimated tax shall be joint and several. If a joint declaration is made but their taxes are determined under this act separately, the estimated tax for such year may be treated as the estimated tax of either husband or wife, or may be divided between them as they may elect.

SECTION 13. Any request for an extension of time, up to but not exceeding nine (9) months, in which to file the individual's tax return will be granted automatically provided the appropriate payment of tax is made on or before the statutory due date of the return and such payment is made on the form prescribed by the department or reasonable facsimile thereof. The appropriate payment will be an amount equal to the prior year's total liability unless a statement is furnished as to the reason the prior year's total liability is not a true indication of present liability or there was no liability for the preceding year. If there was no liability for the preceding year, the total payment must equal at least ninety percent (90%) of the final liability. If the total payment does not equal the prior year's liability as modified by any authorized change or does not equal ninety percent (90%) of the final liability, a penalty shall be applicable to the total

deficient amount of taxes. Any payment of Tennessee estimated income tax made for the tax year or any other credits should be considered in determining the amount to be paid. The deficient amount of taxes shall bear interest at the rate prescribed by Tennessee Code Annotated, Section 67-1-801.

SECTION 14. (a) The commissioner is authorized, with the approval of the comptroller and the governor or the governor's delegate, to enter into an agreement with the secretary of the treasury of the United States or the secretary's delegate, under which, to the extent provided by the terms of the agreement, the secretary or the delegate will assist in the overall administration of the tax. The cost of the services performed by the secretary or the delegate in such activities under the terms of any agreement may be paid from the appropriations for the general operations of the Department of Revenue.

(b) The commissioner is authorized, with the approval of the comptroller and the governor or the governor's delegate, to enter into an agreement with the secretary of the treasury of the United States or the secretary's delegate under which, to the extent provided by the terms of the agreement, the commissioner will undertake to conduct on behalf of the United States any tax administration functions in respect to the federal income tax on individuals. Such agreement shall make provision for the payment by the United States of costs of the services performed on its behalf.

SECTION 15. There is hereby appropriated a sum sufficient to defray the costs of implementing this act. Any expenditure of funds incurred for the implementation of this act must be approved by the commissioner of finance and administration.

SECTION 16. Tennessee Code Annotated, Title 67, Chapter 2, is amended by deleting Chapter 2 in its entirety.

SECTION 17. The provisions of this act are and may be cited as the "Tennessee Tax Reform Act of 1999".

SECTION 18. If Section 2 of this act is held to be invalid and unconstitutional, then all the provisions and applications of this act are declared to be invalid and void. If any other provision of this act or the application thereof to any person or circumstance is held invalid, such invalidity shall not affect other provisions or applications of the act which can be given effect without the invalid provision or application, and to that end the provisions of this act are declared to be severable.

SECTION 19. For purposes of adoption of rules this act shall take effect upon becoming a law, the public welfare requiring it; for purposes of employer registration pursuant to Section 10, this act shall take effect on July 1, 1999, the public welfare requiring it; for purposes of appropriation of funds to administer the provisions of Section 15, this act shall take effect on July 1, 1999; and for all other purposes, this act shall take effect January 1, 2000.